IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. [redacted] 120

BEN BIMBERG & CO., INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

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CITATIONS.

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The petitioner, Ben Bimberg & Co., Inc. prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above case on March 7, 1942, 126 F. (2d) 412, affirming the memorandum decision of the United States Board of Tax Appeals of April 21, 1941. Petition for rehearing was filed March 20, 1942 and on March 27, 1942 the petition was denied. A second petition for rehearing was filed on May 14, 1942 and on May 23, 1942 the petition was denied.

Summary Statement of the Matter Involved.

Petitioner is a wholesaler and jobber of cotton goods. Its general practice is to obtain orders from its customers

for specific merchandise and then place the orders with well-known mills. When these mills are ready to ship the goods, they ship them directly to the customers for the account of petitioner. The mill or other supplier sends an invoice to petitioner, and petitioner simultaneously invoices its customer with the goods in question. In some instances petitioner fills orders from a small inventory kept on hand (R. 22).

In the latter part of 1935, members of the cotton industry believed that the Agricultural Adjustment Act would be invalidated by the Supreme Court. Petitioner and other firms in the cotton market accordingly had their vendors include in their purchase contracts so-called "Charlotte clauses" which provided that if the Act were invalidated, the amount of processing taxes included in the purchase price of the cotton involved would be refunded to petitioner, or credited on the price if the goods had not yet been paid for (R. 22).

After the Supreme Court invalidated the Agricultural Adjustment Act on January 6, 1936, such vendors as had agreed to include the above-mentioned clause in petitioner's purchase contracts promptly issued purchase allowances or credits to petitioner. Petitioner maintained open accounts with its vendors, and while it received some actual cash refunds, most of the refunds were in the form of credit memoranda, which were used to reduce accounts payable owing by petitioner to its vendors (R. 23).

Pursuant to the aforesaid tax clauses, petitioner received during 1936 from its vendors reimbursements or credits in the total sum of $19,763.13 which was the amount of processing taxes charged to petitioner, although unpaid by the mills, on goods shipped to petitioner's accounts during the 90-day period prior to January 6, 1936. These reimbursements and allowances were applicable to cotton goods purchased by petitioner prior to

December 31, 1935 and, with certain small exceptions, sold by it before that date (R. 23).

Of the sum of $19,763.13 which petitioner received as reimbursements or credits from its vendors, the amount of $7,729.45 was originally reported as income for 1936 and a tax was paid on it. The balance of $12,033.68 was not reported as income for that year. Petitioner had executed credit memos in that latter amount all dated in 1936, drawn to its vendees for the equivalent of the processing taxes included in the purchase price of purchases made by them for 90 days prior to January 6, 1936. On March 15, 1937, petitioner cancelled all of the credit memos in the total amount of $12,033.68 (R. 23).

The petitioner's books, which were kept on the accrual basis, did show the full amount of taxes in question, $19,763.13 as a deduction from gross income. In determining its taxable income for the year 1935, petitioner had included the sum of $19,763.13 (for which sum petitioner was subsequently reimbursed by its vendors as aforesaid) as part of the cost of goods sold (R. 24).

Petitioner has at all times kept its books on an accrual basis (R. 24).

The United States Board of Tax Appeals sustained the action of the Commissioner in imposing a 25% delinquency penalty for late filing of the 1936 tax return stating that there was not "reasonable cause" within Section 291 of the Revenue Act of 1936 (R. 25).

Jurisdiction.

The jurisdiction of this Court is invoked under the Act of February 13, 1925 (C. 229, 43 Stat. 938) amending the Judicial Code, Section 240; Title 28 U. S. C. A. Section 347. The judgment sought to be reviewed is that of the United States Circuit Court of Appeals for the Second Circuit entered on March 7, 1942, 126 F. (2d) 412,

affirming the memorandum decision of the United States Board of Tax Appeals of April 21, 1941.

Questions Presented.

1. Were the reimbursements received by petitioner from its vendors income in the year 1935 or 1937, and not in the year 1936?
2. If the reimbursements were income in 1935, is it sufficient if petitioner give the Commissioner an adequate opportunity to readjust the 1935 tax return?
3. Is petitioner entitled to a refund of income tax paid for the year 1936 in the amount of $954.60?
4. Is the petitioner correct in disputing the imposition of a deficiency in income tax for the calendar year 1936, at least as to reimbursements received in the amount of $12,033.68?
5. Is the petitioner correct in asserting that no penalty is due for the calendar year 1936?

Reasons Relied Upon for the Allowance of the Writ.

I.

The Court below has ruled on an important question of federal law which has not been, but should be, settled by this court. The question is: Whether a taxpayer who has subsequently been given a refund or reimbursement due to the unconstitutionality of a statute must bring the refund or reimbursement to the Commissioner's notice as soon as he receives it, if he wishes to have his earlier tax return readjusted, or on the other hand, must merely give the Commissioner an adequate opportunity to read-

just the earlier return at any reasonable time before the statute of limitations has run. The Court below adopted the former view which the petitioner considers to be erroneous, harsh and arbitrary.

It is the petitioner's contention that the Commissioner should cancel a deduction taken in one year for an expense which the taxpayer has accrued or paid where the expense item has been refunded in a later year (because it was unlawfully superimposed on a purchase contract or group of contracts) if the statute of limitations has not yet run. It is also the petitioner's position that so long as the taxpayer gives the Commissioner an adequate opportunity to readjust the earlier year before the statute of limitations has run, that suffices on the issue of notice to the Commissioner. In the instant case the petitioner did in fact give the Commissioner several adequate opportunities to readjust its prior income tax return for 1935 long before the statute of limitations had run to prevent such reassessment (R. 40, 42-43).

Because of the numerous cases that concern refunds under the Agricultural Adjustment Act and other unconstitutional statutes where at the time that the refund or reimbursement is made the statute of limitations is yet no bar to a readjustment of the earlier return it is respectfully submitted that the Supreme Court should decide this question: Whether a taxpayer to obtain a reassessment must notify the Commissioner of his refund as soon as it is received, or on the other hand, must merely give the Commissioner an adequate opportunity through notice, before the statute of limitations has run, to readjust the earlier return. Petitioner submits the latter is the correct and more equitable view; and furthermore, that in the instant case such adequate notice and opportunity was afforded to the Commissioner.

II.

The decision of the Court below if construed to mean that the Commissioner, even though the earlier year is still open, may at his pleasure reassess the original tax or include the refund in the income for the later year is not only in conflict with the decisions of the First and Fourth Circuit Courts of Appeal in *Leach* v. *Commissioner*, 50 F. (2d) 371 (1931 C. C. H. Par. 9416) and *Inland Products Co.* v. *Blair*, 31 F. (2d) 867 (1 U. S. T. C. Par. 390) respectively, but establishes an arbitrary, capricious and one-sided doctrine not sustained by any of the cases.

If the Court below disagreed with the aforesaid cases, it did so on the basis of no cited authority. The cases of *Houbigant, Inc.* v. *Commissioner*, 31 B. T. A. 954, aff. *per curiam*, 80 F. (2d) 1012, cert. denied, 298 U. S. 669, *Nash* v. *Commissioner*, 88 F. (2d) 477 (C. C. A. 7) (37-1 U. S. T. C. Par. 9091), cert. denied 301 U S. 700, *Union Trust Co.* v. *Commissioner*, 111 F. (2d) 60 (C. C. A. 7) (40-1 U. S. T. C. Par. 9273) were recognized by the Court below as distinguishable from the instant case and the *Leach* and *Inland Products Co.* cases, for in those cases the time had passed to assess a deficiency for the earlier year and thus the Courts allowed the Commissioner to surcharge the income for the year of the refund. However, in the present case, as in the *Leach* and *Inland Products Co.* cases, the earlier year was still open and the statute of limitations did not prevent a reassessment of the earlier return.

III.

It is well settled law among the lower courts that the Commissioner should readjust the original deduction on account of refunds of taxes illegally assessed and col-

lected, where correction of the prior return is not prevented by the statute of limitations.

See:

Inland Products Co. v. *Blair,* 31 F. (2d) 867 (C. C. A. 4, 1929);
Bergan v. *Commissioner,* 80 F. (2d) 89 (C. C. A. 2, 1935);
Leach v. *Commissioner,* 50 F. (2d) 371 (C. C. A. 1, 1931);
Bohemian Breweries, Inc. v. *United States,* 27 F. Supp. 588, 89 Ct. Cl. 57 (1939);
E. B. Elliott Co. v. *Commissioner,* 45 B. T. A. 82 (1941).

It is also established law among the lower courts that where an additional assessment has been barred by the expiration of the period of limitation the refund is considered as income for the year in which the refund took place (except if the year in which the tax was first paid resulted in a net deficit).

See:

Houbigant, Inc. v. *Commissioner, supra;*
Nash v. *Commissioner, supra;*
Union Trust Co. v. *Commissioner, supra.*

Petitioner must point out that the *Houbigant* and *Nash* cases, wherein the Supreme Court denied certiorari, were both cases where the statute of limitations prevented a reassessment of the earlier return unlike the situation in the instant case, and secondly, an issue in those cases, not involved in the present case, was whether there was a return of capital or income.

In the instant case the earlier year 1935 was still open and the statute of limitations did not prevent a reassess-

ment of the earlier tax year. Too, the petitioner does not dispute the fact that the reimbursements are income; the question here is for what year are they to be treated as income.

The history of the Treasury Department's rulings since 1920 reveals the aforesaid principles to be the policy advocated by the Treasury itself.

O. D. 741, C. B. 3, p. 115 (July-December, 1920);
Mim. 3958, C. B. XI-2, p. 33 (July-December, 1932);
Mim. 4564, C. B. 1937-1, p. 93.

The cases involving A. A. A. reimbursements should adhere to the same doctrine discussed above; namely, that a refund of an unconstitutional or erroneously paid tax is income in the year the refund is received when the year of deduction is barred by the statute of limitations; but that when the year of deduction is not outlawed the income for such year should be adjusted to include the amount of refunded taxes.

Furthermore, the United States Board of Tax Appeals has consistently held that it is proper for a first processor to accrue the amounts to be paid out to its vendees under "Charlotte clauses" as an expense or set-off against sales for the year 1935.

See:

Sanford Cotton Mills, Inc. v. *Commissioner,* 42 B. T. A. 190 (1940), (N. A.) 1940-2 C. B. 14, and G. C. M. 22404, 1940-2 C. B. 204, I. T. 3430, 1940-2 C. B. 205 (No Appeal):
Cartex Mills, Inc. v. *Commissioner,* 42 B. T. A. 894 (1940), (N. A.) 1940-2 C. B. 9;
Smith Packing Co. v. *Commissioner,* 42 B. T. A. 1054 (1940);

Cannon Valley Milling Co. v. *Commissioner,* 44 B. T. A. 763 (1941), (N. A.) 1941 P-H par. 66, 367, App. (C) July 14, 1941 (C. C. A. 8);
Security Flour Mills Co. v. *Commissioner,* 45 B. T. A. 671 (1941), (N. A.) 1942 P-H par. 66,094, App. (T) Feb. 11, 1942 (C. C. A. 10), App. (C) Mar. 26, 1942 (C. C. A. 10).

If it is proper as a matter of practical accounting for a vendor to accrue the amounts to be paid out to its vendees under "Charlotte clauses" as an expense or setoff against sales for the year 1935, it would follow as a necessary corollary that petitioner, as vendee, should accrue these reimbursements as income or a reduction of costs in the same year. Where both the first processor and its vendee are on the accrual basis, it would unnecessarily complicate accounting practice to hold the obligation of the vendor to make a refund was accruable in 1935, but that the right of receipt of the vendee could not be accrued in the year 1935. All of the events in the instant case relate to 1935, at least as much as in the cases of *Sanford Cotton Mills, Inc., Cartex Mills, Inc., Smith Packing Co.* and *Cannon Valley Milling Co., supra.*

An illustration of such proper accounting practice can be found, among other fields, in the field of mortgages. When the mortgagor on the accrual basis is entitled to a deduction for interest accrued in one year, the mortgagee also on the accrual basis is deemed to have received income in that very same year.

Cf: *Midland Mutual Life Insurance Co.* v. *Commissioner,* 300 U. S. 216, 57 Sup. Ct. 423, reh. denied 300 U. S. 688, 57 Sup. Ct. 752.

In *Sanford Cotton Mills, Inc., supra,* the Board of Tax Appeals held that a first processor who made reimburse-

ments to its vendees in 1936 under the so-called "Charlotte clauses" (whose vendees were in the same position as petitioner), could properly accrue this expense for the year 1935 rather than in 1936. The Board so held because, as a practical matter, all the essential facts related to 1935 and the only event which occurred in 1936 was the decision of the Supreme Court invalidating the Agricultural Adjustment Act. Although this case was nonacquiesced, the Government did not take an appeal and the Bureau in effect adopted the decision in G. C. M. 22404, 1940-2 C. B. 204 and I. T. 3430, 1940-2 C. B. 205.

The Board of Tax Appeals in its opinion attempted to distinguish the instant case from *Sanford Cotton Mills, Inc.* and *Cartex Mills, Inc., supra,* on the ground that in those cases the first processors

> "had accrued liabilities to pay sums in either of two events: if the processing tax were upheld, they were obligated to pay the tax to the Government; if it were held invalid, they were under a similar obligation to refund the amount of the tax to their vendees. In other words, the obligation to pay the amount of the taxes to somebody was fixed, in any event, in 1935" (R. 24).

However, the facts in the *Sanford Cotton Mills, Inc.* case, *supra,* do not warrant this distinction. In that case, the Board stated, p. 191;

> "In closing its 1935 accounts, which it did early in 1936, petitioner canceled the aforesaid accrual of $64,599.25 (which it had not paid) as its liability to the United States for tax on cotton processed in 1935, and substituted $22,468.12 which was the amount of its contractual liability for readjustment

to its vendees. This contractual liability it actually discharged in the first seven months of 1936."

It is thus apparent that the amount of accrual was not fixed and payable at all events, but that a liability accrued on the books of the corporation was subsequently canceled and an entirely different liability in a much less amount was substituted therefor. There was a difference of $42,131.13 between the two liabilities, which sum was subsequently reflected on the books of the corporation as an increase of net income for 1935.

The foregoing summary review of the cases and precedents show that the taxpayer is fully justified in its claim that the A. A. A. reimbursements of $19,763.13 are not taxable as income in 1936.

Wherefore, it is respectfully submitted that the petition should be granted.

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